

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

| | | | | |
|---|--------------|-----------------|--------------------------------------|--------|
| Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other | | Local Unit Name | | County |
| Fiscal Year End | Opinion Date | | Date Audit Report Submitted to State | |

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).


YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

| | | | | |
|--|--------------------------|--|----------------|-----|
| We have enclosed the following: | Enclosed | Not Required (enter a brief justification) | | |
| Financial Statements | <input type="checkbox"/> | | | |
| The letter of Comments and Recommendations | <input type="checkbox"/> | | | |
| Other (Describe) | <input type="checkbox"/> | | | |
| Certified Public Accountant (Firm Name) | | Telephone Number | | |
| Street Address | | City | State | Zip |
| Authorizing CPA Signature  | Printed Name | | License Number | |

South Macomb Disposal Authority

Financial Report

June 30, 2006

South Macomb Disposal Authority

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Independent Auditor's Report

To the Board of Directors
South Macomb Disposal Authority

We have audited the accompanying basic financial statements of South Macomb Disposal Authority as of June 30, 2006 and for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of South Macomb Disposal Authority at June 30, 2006 and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

October 24, 2006

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South Macomb Disposal Authority

Management's Discussion and Analysis

Using this Annual Report

South Macomb Disposal Authority (the "Authority") is a joint venture of five cities located in southern Macomb County: Center Line, Eastpointe, Roseville, St. Clair Shores, and Warren. The primary roles of the Authority are to manage the transfer of solid waste currently collected by all of the member cities (except Warren) and to provide for the postclosure care of landfill sites previously operated by the Authority. The Authority does not currently operate any landfill sites. This annual report consists of a series of financial statements. The statement of net assets and the statement of revenue, expenses, and changes in net assets provide information about the financial activities of the Authority. These are followed by the statement of cash flows, which presents detailed information about the changes in the Authority's cash position during the year.

Financial Overview

In analyzing the Authority's financial position, it is important to recognize the dual missions of the Authority. From a financial perspective, the Authority's core objective (and ongoing operation) is to manage the costs of solid waste transfer for Center Line, Eastpointe, Roseville, and St. Clair Shores. With respect to this core objective, the Authority acts as a conduit for the four participating members. The amounts to be charged to the participating members for these services will, therefore, approximate the Authority's costs of providing solid waste transfer services. The key financial statistics for the Authority, therefore, relate to measurements of the ability to reduce total costs to its members (as opposed to the ability to accumulate financial resources). To this end, the net assets of the Authority related to ongoing operations are approximately \$1,279,000, of which approximately \$533,000 is invested in capital assets.

The other objective of the Authority is to provide for the postclosure care of landfill sites previously operated by the Authority, including all of its original five member cities. In prior years, the Authority successfully sued its insurers and received a settlement for remediation of its previously owned sites. Under the terms of the settlement, the Authority's continuing insurance coverage is limited to costs of defense, past response costs, and the cost of remedial investigation on any owned sites for which the Authority has continuing maintenance and monitoring responsibilities. At June 30, 2006, the Authority has two remaining landfill sites. The Authority has recorded an estimated liability for a study on these two landfill sites to assess the level of contamination and to determine the level of potential remediation costs. The entire liability related to this study has been recorded as a current liability of \$280,000.

During the current year, the Authority accrued and paid subsequent to year end \$950,000 for the settlement to the last plaintiff in a series of lawsuits filed 23 years ago for contamination to the plaintiff's land caused from the adjacent landfills that the Authority previously owned. The entire liability is recorded as a short-term liability at June 30, 2006.

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

Financial Overview (Continued)

In addition, the Authority had previously received a total of approximately \$5,700,000 in landfill grant funds from the State of Michigan to assist with the remediation of sites 9 and 9a that are no longer owned by the Authority. The State demanded that these funds be returned since the Authority received reimbursement from its insurers. On May 4, 2005, the Macomb County Circuit Court upheld the State's demand, which the Authority appealed to the State of Michigan Court of Appeals. On October 17, 2006, the State of Michigan Court of Appeals affirmed the decision and mandated the Authority to pay back to the State of Michigan the grant monies previously received. However, the State of Michigan Court of Appeals indicated that the current ruling could be reduced by previous costs the Authority incurred in obtaining the insurance reimbursement for the sites. The State of Michigan Court State of Appeals directed this decision to be made at the Macomb County Circuit Court level. The amount currently owed to the State of Michigan is approximately \$5,700,000. If the Authority is ultimately required to pay all the grant monies back to the State, the attorneys that represented the Authority in its claim against the insurers will reimburse approximately \$400,000 of legal fees to the Authority. The payable and receivable are reflected in the Authority's balance sheet as of June 30, 2006.

All pending lawsuits and remediation costs related to the previously owned Red Run Drain Landfill site have been fully settled and paid during the current year and the related liabilities and receivables have been removed from the Authority's statement of net assets as of June 30, 2006. In total, the Authority paid out approximately \$2,378,000 net of third-party reimbursements and received approximately \$4,200,000 in reimbursements from its insurer related to these sites during the current year.

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following table presents condensed information about the Authority's financial position compared to the prior year.

| | Year Ended June 30 | | Change | |
|----------------------------|---------------------|---------------------|---------------------|---------|
| | 2006 | 2005 | Amount | Percent |
| Assets | | | | |
| Current assets | \$ 11,862,094 | \$ 14,506,809 | \$ (2,644,715) | -18 |
| Capital assets | 999,161 | 1,039,821 | (40,660) | -4 |
| Total assets | 12,861,255 | 15,546,630 | (2,685,375) | -17 |
| Liabilities | | | | |
| Current liabilities | 1,635,775 | 3,499,626 | (1,863,851) | -53 |
| Long-term liabilities | 5,700,400 | 5,950,000 | (249,600) | -4 |
| Total liabilities | 7,336,175 | 9,449,626 | (2,113,451) | -22 |
| Net Assets | | | | |
| Invested in capital assets | 999,161 | 1,039,821 | (40,660) | -4 |
| Unrestricted | 4,525,919 | 5,057,183 | (531,264) | -11 |
| Total net assets | <u>\$ 5,525,080</u> | <u>\$ 6,097,004</u> | <u>\$ (571,924)</u> | -9 |

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

The following table presents condensed information about the Authority's revenues and expenses compared to the prior year.

| | Year Ended June 30 | | Change | |
|--|---------------------|---------------------|-----------------------|---------|
| | 2006 | 2005 | Amount | Percent |
| Operating Revenue | | | | |
| Disposal fees | \$ 1,448,116 | \$ 1,510,338 | \$ (62,222) | -4 |
| Administrative fees | 77,835 | 59,447 | 18,388 | 31 |
| Total operating revenue | 1,525,951 | 1,569,785 | (43,834) | -3 |
| Operating Expenses | | | | |
| Operations and maintenance | 151,288 | 95,219 | 56,069 | 59 |
| General and administrative | 61,327 | 46,704 | 14,623 | 31 |
| Contracted disposal costs | 1,273,234 | 1,142,496 | 130,738 | 11 |
| Total operating expenses | 1,485,849 | 1,284,419 | 201,430 | 16 |
| Nonoperating Revenue (Expenses) | | | | |
| Postclosure and remediation costs | (14,508) | (42,856) | 28,348 | -66 |
| Reimbursements related to remediation - | | | | |
| Insurance and other | - | 800,000 | (800,000) | -100 |
| Lawsuit settlement related to closed sites | (950,000) | - | (950,000) | - |
| Gain on sale of land | - | 420,315 | (420,315) | -100 |
| Investment and other income | 556,908 | 340,737 | 216,171 | 63 |
| Other legal expenses related to closed sites | (204,426) | (64,739) | (139,687) | 216 |
| Total nonoperating revenue (expense) | (612,026) | 1,453,457 | (2,065,483) | -142 |
| Net income (loss) | <u>\$ (571,924)</u> | <u>\$ 1,738,823</u> | <u>\$ (2,310,747)</u> | -133 |

Significant Variances from Prior Year

The decrease in the Authority's total net assets from the prior year is mainly due to the \$950,000 lawsuit settlement expensed in the current year and described in detail in the above financial overview section of the management's discussion and analysis. In addition, the net loss was further increased by the legal expenses related to the postclosure care litigation of approximately \$204,000. These postclosure litigation costs were partially offset by the investment earnings in the current year of approximately \$557,000 and operating income of approximately \$40,000. These items accounted for the majority of the net loss in the current year.

South Macomb Disposal Authority

Management's Discussion and Analysis (Continued)

At June 30, 2006, the Authority has only two landfill sites for which it is responsible for future postclosure care. Annually, the Authority expenses any postclosure care costs related to the two remaining sites of the Authority. In addition, the Authority has recorded an estimated liability for a study on these two landfill sites to assess the level of contamination and to determine the level of potential remediation costs. The entire liability related to this study has been recorded as a current liability of \$280,000.

Net Asset Designations and Risk Management

The Authority has potentially significant economic issues to resolve over the next several years related to the two remaining landfill sites. The potential liability will be assessed further in the contamination assessment projected to be completed by June 30, 2007. The accumulated net assets for postclosure care costs have been set aside by the Authority's governing body to serve as a reserve fund for potential remediation costs for which the Authority is now uninsured.

Economic Factors and Next Year's Budget

For ongoing solid waste transfer operations, costs will be dependent on the volume of solid waste hauled. The Authority's budget for the year ending June 30, 2007 forecasts a moderate increase in solid waste and, therefore, costs.

The Authority has estimated and recorded the known post closure care liabilities related to the assessment study as of June 30, 2006. There are no other claims against the Authority that would result in funding by the Authority as of June 30, 2006. However, the Authority will amend its budget as necessary for additional costs assessed by the State of Michigan or other regulatory authorities.

Contacting the Authority's Management

This financial report is intended to provide our member cities with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives from the member cities and other sources. If you have questions about this report or need additional information, we welcome you to contact the Authority's offices.

South Macomb Disposal Authority

Statement of Net Assets June 30, 2006

Assets

| | |
|--|----------------|
| Cash and cash equivalents (Note 3) | \$ 10,553,644 |
| Investments (Note 3) | 430,988 |
| Accounts receivable | 386,624 |
| Accrued interest receivable | 70,256 |
| Prepaid insurance | 8,282 |
| Receivables related to site remediation - Insurance and other (Note 7) | 412,300 |
| Land | 254,963 |
| Capital assets (Note 4) | <u>744,198</u> |

Total assets 12,861,255

Liabilities

| | |
|--|------------------|
| Accounts payable | 405,775 |
| Accrued postclosure care and remediation liabilities (Note 7): | |
| Due within one year | 1,230,000 |
| Due in more than one year | <u>5,700,400</u> |

Total liabilities 7,336,175

Net Assets

| | |
|----------------------------|------------------|
| Invested in capital assets | 999,161 |
| Unrestricted (Note 5) | <u>4,525,919</u> |

Total net assets \$ 5,525,080

South Macomb Disposal Authority

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2006

Operating Revenue

| | |
|-----------------------|---------------|
| Disposal fees | \$ 1,434,120 |
| Closure cost billings | 13,996 |
| Administrative fees | <u>77,835</u> |

Total operating revenue 1,525,951

Operating Expenses

| | |
|----------------------------|------------------|
| Operations and maintenance | 151,288 |
| General and administrative | 61,327 |
| Contracted disposal costs | <u>1,273,234</u> |

Total operating expenses 1,485,849

Operating Income 40,102

Nonoperating Revenue (Expenses)

| | |
|---|------------------|
| Postclosure and remediation costs (Note 8) | (14,508) |
| Investment interest income | 556,908 |
| Lawsuit settlements related to closed sites (Note 8) | (950,000) |
| Other legal expenses related to closed sites (Note 8) | <u>(204,426)</u> |

Total nonoperating expenses (612,026)

Net Loss (571,924)

Net Assets - Beginning of year 6,097,004

Net Assets - End of year \$ 5,525,080

South Macomb Disposal Authority

Statement of Cash Flows Year Ended June 30, 2006

Cash Flows from Operating Activities

| | |
|---|--------------------|
| Cash received from customers | \$ 1,468,153 |
| Cash payments to suppliers for goods and services | <u>(1,276,425)</u> |
| Net cash provided by operating activities | 191,728 |

Cash Flows from Noncapital Financing Activities -

| | |
|--|-----------|
| Net settlement of postclosure care and remediation costs | 1,594,552 |
|--|-----------|

Cash Flows from Investing Activities

| | |
|---|----------------|
| Net change of investments | 43,081 |
| Interest received on investments | <u>496,556</u> |
| Net cash provided by investing activities | <u>539,637</u> |

| | |
|--|------------------|
| Net Increase in Cash and Cash Equivalents | 2,325,917 |
|--|------------------|

| | |
|---|-------------------------|
| Cash and Cash Equivalents - July 1, 2005 | <u>8,227,727</u> |
|---|-------------------------|

| | |
|--|----------------------------|
| Cash and Cash Equivalents - June 30, 2006 | <u>\$10,553,644</u> |
|--|----------------------------|

Cash Flows from Operating Activities

| | |
|--|--------------------------|
| Operating income | \$ 40,102 |
| Adjustments to reconcile operating income to net cash from operating activities: | |
| Depreciation | 40,661 |
| Changes in assets and liabilities: | |
| Increase in accounts receivable | (57,798) |
| Decrease in accounts payable | <u>168,763</u> |
| Net cash provided by operating activities | <u>\$ 191,728</u> |

Noncash Activities - There were no significant noncash operating, financing, or investing activities during the year ended June 30, 2006.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 1 - Nature of Business and Significant Accounting Policies

South Macomb Disposal Authority (the "Authority") consists of five member municipalities in Macomb County, Michigan. The Authority currently provides refuse disposal services primarily for the benefit of four of the five member municipalities. The governing body of the Authority consists of five members - one appointed by each of the five member communities.

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to an Enterprise Fund of a governmental unit. Accordingly, the accrual basis of accounting is followed by the Authority. In accordance with accounting principles generally accepted in the United States of America, there are no component units to be included in these financial statements.

Fixed Assets - Fixed assets are recorded at cost and are shown net of accumulated depreciation. Depreciation is computed using the straight-line method.

Cash Equivalents - For the purpose of the statement of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Investments - Investments are valued at fair value.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Other accounting policies are disclosed in other notes to the financial statements.

Note 2 - Stewardship, Compliance, and Accountability

Noncompliance with Legal or Contractual Provisions - The Authority has not currently adopted a formal policy to make and accept electronic fund transfers (ACH Payments). A formal policy is required under Public Act 738.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Authority has designated five banks for the deposit of its funds. The Authority invests in accordance with Public Act 196 of 1997, but it has not adopted a formal investment policy. The Authority's deposits are in accordance with statutory authority.

The Authority's cash and investments are subject to custodial credit risk, which is examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not specifically address a deposit policy for custodial credit risk. At year end, the Authority had \$10,690,255 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Authority evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 4 - Capital Assets

Capital asset activity for the year ended June 30, 2006 was as follows:

| | 2005 | Additions | 2006 | Depreciable Life - Years |
|--------------------------------------|-------------------|--------------------|-------------------|-----------------------------|
| Capital assets being depreciated: | | | | |
| Site improvements | \$ 585,145 | \$ - | \$ 585,145 | 40 |
| Equipment | 346,848 | - | 346,848 | 7-15 |
| Waste transfer station | 1,201,645 | - | 1,201,645 | 40 |
| Transfer station equipment | 36,807 | - | 36,807 | 10-15 |
| Subtotal | 2,170,445 | - | 2,170,445 | |
| Less accumulated depreciation for: | | | | |
| Site improvements | (241,980) | (14,703) | (256,683) | |
| Equipment | (346,014) | (834) | (346,848) | |
| Waste transfer station | (760,785) | (25,124) | (785,909) | |
| Transfer station equipment | (36,807) | - | (36,807) | |
| Subtotal | (1,385,586) | (40,661) | (1,426,247) | |
| Net capital assets being depreciated | <u>\$ 784,859</u> | <u>\$ (40,661)</u> | <u>\$ 744,198</u> | |

Note 5 - Net Assets

The Authority has designated certain net assets related to postclosure care and potential remediation activities. The designated net assets include proceeds from several litigation settlements with the Authority's insurers for remediation of the Authority's landfill sites. As part of these settlements, the insurers may be held to pay future defense costs but not remediation costs for the remaining two sites operated by the Authority. The amount of net assets designated totals \$4,246,000, which includes approximately \$466,000 of the capital assets of the Authority. The Authority has designated these funds in a postclosure care/insurance reserve fund to pay for the potential remediation of the remaining two landfill sites (see Note 7).

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 6 - Risk Management

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Authority has purchased commercial insurance for medical and life insurance claims and participates in the Michigan Municipal League risk pool for claims relating to property loss, torts, errors and omissions, and employee injuries (workers' compensation). Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

The Michigan Municipal League risk pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Note 7 - Postclosure Care, Remediation Costs, Commitments, and Contingent Liabilities

Current state and federal laws and regulations require final covers on active landfill sites and the performance of certain maintenance and monitoring functions at the site for 30 years after closure. As of June 30, 2006, the Authority has two landfill sites for which it has continuing postclosure maintenance and monitoring responsibilities. The Authority reports annual closure and postclosure care costs as an operating expense in each fiscal year.

The Authority has also recorded an estimated liability for a study on these two landfill sites to assess the level of contamination and to determine the level of potential remediation costs. The entire liability related to this study has been recorded as a current liability of \$280,000.

During the current year, the Authority accrued and then paid subsequent to year end \$950,000 for the settlement to the last plaintiff in a series of lawsuits filed 23 years ago for contamination to the plaintiff's land caused from the adjacent landfills that the Authority previously owned. The entire liability is recorded as a short-term liability at June 30, 2006.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 7 - Postclosure Care, Remediation Costs, Commitments, and Contingent Liabilities (Continued)

The Authority had previously received a total of approximately \$5,700,000 in landfill grant funds from the State of Michigan to assist with the remediation of sites 9 and 9a that are no longer owned by the Authority. The State demanded that these funds be returned since the Authority received reimbursement from its insurers. On May 4, 2005, the Macomb County Circuit Court upheld the State's demand, which the Authority appealed to the State of Michigan Court of Appeals. On October 17, 2006, the State of Michigan Court of Appeals affirmed the decision and mandated the Authority to pay back to the State of Michigan the grant monies previously received. However, the State of Michigan Court of Appeals indicated that the current ruling could be reduced by previous costs the Authority incurred in obtaining the insurance reimbursement for the sites. The State of Michigan Court of Appeals directed this decision to be made at the Macomb County Circuit Court level. The amount currently owed to the State of Michigan is approximately \$5,700,000. If the Authority is ultimately required to pay all the grant monies back to the State, the attorneys that represented the Authority in its claim against the insurers will reimburse approximately \$400,000 of legal fees to the Authority. The payable and receivable are reflected in the Authority's balance sheet as of June 30, 2006.

All pending lawsuits and remediation costs related to the previously owned Red Run Drain Landfill site have been fully settled and paid during the current year and the related liabilities and receivables have been removed from the Authority's statement of net assets as of June 30, 2006. In total, the Authority paid out approximately \$2,378,000 net of third-party reimbursements and received approximately \$4,200,000 in reimbursements from its insurer related to these sites during the current year.

Note 8 - Postemployment Benefits

The Authority provides health care benefits to all full-time employees upon retirement. Currently, three retirees are receiving benefits. The Authority includes retirees and their dependents in its insured health care plan, with no contribution required by the participants. Expenditures for postemployment health care benefits are recognized as insurance premiums become due; during the year, this amount was approximately \$2,520.

South Macomb Disposal Authority

Notes to Financial Statements June 30, 2006

Note 8 - Postemployment Benefits (Continued)

Upcoming Reporting Change - The Governmental Accounting Standards Board has recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any “other” postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending June 30, 2010.



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October 27, 2006

To the Board Members
South Macomb Disposal Authority
20001 Pleasant Avenue
St. Clair Shores, MI 48080

Dear Board Members:

We have recently completed our audit of the financial statements of South Macomb Disposal Authority for the year ended June 30, 2006. The purpose of this communication is to provide you with additional information regarding the scope and results of our audit that may assist you with your oversight responsibilities of the financial reporting process for which management is responsible. This report is intended solely for the use of the board members and others within the organization.

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

We conducted our audit of the financial statements of the South Macomb Disposal Authority in accordance with generally accepted auditing standards. The following paragraphs explain our responsibilities under those standards.

Management has the responsibility of adopting sound accounting policies, of maintaining an adequate and effective system of accounts, of the safeguarding of assets, and of devising internal controls that will, among other things, help assure the proper recording of transactions. The transactions that should be reflected in the accounts and in the financial statements are matters within the direct knowledge and control of management. Our knowledge of such transactions is limited to that acquired through our audit. Accordingly, the fairness of representations made through the financial statements is an implicit and integral part of management's responsibility. We may make suggestions as to the form or content of the financial statements or even draft them, in whole or in part, based on management's accounts and records. However, our responsibility for the financial statements is confined to the expression of an opinion on them. The financial statements remain the representations of management.

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The concept of materiality is inherent in the work of an independent auditor. An auditor places greater emphasis on those items that have, on a relative basis, more importance to the financial statements and greater possibilities of material error than with those items of lesser importance or those in which the possibility of material error is remote. For this purpose, materiality has been defined as “the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.”

An independent auditor’s objective in an audit is to obtain sufficient competent evidential matter to provide a reasonable basis for forming an opinion on the financial statements. In doing so, the auditor must work within economic limits; the opinion, to be economically useful, must be formed within a reasonable length of time and at reasonable cost. That is why an auditor’s work is based on selected tests rather than an attempt to verify all transactions. Since evidence is examined on a test basis only, an audit provides only reasonable assurance, rather than absolute assurance, that financial statements are free of material misstatement. Thus, there is a risk that audited financial statements may contain undiscovered material errors or fraud. The existence of that risk is implicit in the phrase in the audit report, “in our opinion.”

Internal Controls

In planning and performing our audit of the financial statements of South Macomb Disposal Authority for the year ended June 30, 2006, we considered the Authority’s internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted a matter involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Authority’s ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Segregation of accounting duties is a fundamental control activity that separates the duties of authorization, recordkeeping, and custody of assets. Incompatible functions place a person in the position to both perpetrate and conceal errors or fraud in the normal course of his or her duties. Due to its limited staff size, the Authority does not have an adequate segregation of accounting duties. We consider this item to be a reportable condition.

October 27, 2006

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control structure would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we do not believe that the reportable condition noted above is a material weakness.

As always, we thank the board for the opportunity to serve. We would be happy to answer any questions you may have regarding the annual financial report and would be pleased to discuss the above comments and recommendations with you at your convenience.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in black ink, appearing to read "Mark R. Hurst", with a stylized flourish at the end.

Mark R. Hurst